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No. 356

In the Supreme Court of the United States

OCTOBER TERM, 1931

THE UNITED STATES OF AMERICA, PETITIONER

v.

HOME TITLE INSURANCE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

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CITATIONS

Cases:

Bowers v. *Lawyers Mortgage Co.*, No. 355, October Term, 1931 — 2, 8, 9, 11

Trenton Potteries Co. v. *Title Guaranty & Trust Co.*, 50 App. Div. 490 — 10

Statutes:

Revenue Act of 1921, c. 136, 42 Stat. 227, 262, 294—

Sec. 246 — 2

Sec. 1000 — 2

Revenue Act of 1924, c. 234, 43 Stat. 253, 290, 325—

Sec. 246 (U. S. C., Title 26, sec. 1006) — 2

Sec. 700 (U. S. C., Title 26, sec. 223) — 2

Insurance Law of New York, Art. V, Laws 1892, c. 690 — 4

Miscellaneous:

G. C. M. 5355, C. B. VII–2, p. 160 (1928) — 10

S. M. 5501, C. B. V–1, p. 102 (1926) — 10

G. C. M. 6988, C. B. VIII–2, p. 213 (1929) — 13

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OPINIONS BELOW

The opinion of the District Court (R. 23–29) is reported in 41 F. (2d) 793. The opinion of the Circuit Court of Appeals (R. 65–72) is reported in 50 F. (2d) 107.

JURISDICTION

The judgment sought to be reviewed was entered June 8, 1931. (R. 72.) Petition for certiorari was filed on September 5, 1931, and the writ was granted October 26, 1931. The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the provisions of the Revenue Acts of 1921 and 1924 to the effect that the capital stock taxes imposed thereby "shall not apply * * * to any insurance company subject to the tax imposed by section * * * 246" were applicable to the respondent, a corporation carrying on the businesses of title insurance, of making loans on mortgages on real estate, and of selling the loans with its guaranties of the bonds and mortgages securing loans.

STATUTES INVOLVED

The statutes primarily involved are Sections 246 and 1000 of the Revenue Act of 1921, c. 136, 42 Stat. 227, 262, 294, and Sections 246 and 700 of the Revenue Act of 1924, c. 234, 43 Stat. 253, 290, 325. The applicable sections of the Revenue Act of 1921 are printed in Appendix A of the petitioner's brief in *Bowers* v. *Lawyers Mortgage Company,* No. 355, pp. 42–46. Section 246 of the 1924 Act is practically identical with Section 246 of the 1921 Act and Section 700 of the 1924 Act is practically identical with Section 1000 of the 1921 Act.

STATEMENT

The respondent filed capital stock returns for the period from July 1, 1922, to June 30, 1923, and for the period from July 1, 1923, to June 30, 1924. In each of these it described its business as "Real Estate, Title Insurance and Mortgages," and each

of the returns showed a tax to be due. (R. 12–13, Exhibits C and E.) The respondent filed a capital stock tax return for the period from July 1, 1924, to June 30, 1925, in which it described its business as "Title & Mortgage Insurance" and asserted that "insurance companies are exempt from this tax." (R. 13, Exhibit H.) The respondent also duly filed returns for the corporation income tax for the calendar years 1921, 1922, 1923, and 1924. (Exhibits P, Q, R, S.) In each of these it described its business as "Title insurance and Mortgages." The first of these returns was a consolidated return including the income of the two subsidiaries of the respondent, the Home Investment Company of New York and the Jay Holding Corporation. Although the income tax returns reported as income items which we conceive not to be required of insurance companies under the law and the tax was paid on the net income so computed, the respondent raises no question as to its liability for these taxes. But it does contest its liability for the capital stock taxes for the three periods above mentioned. These capital stock taxes were evidently all paid under protest and duress on February 4, 1926. (R. 13–14.) On February 10, 1926, the respondent filed claims for refund of the capital stock taxes for the three periods. (R. 13–14, Exhibits D, F, I.) In these it answered the question "business in which engaged" merely with the words "Title Insurance," and asserted that the company, "being an insur-

ance company, is not liable for a capital stock tax." (R. 12–14.)

The claims were duly rejected (R. 13–14) and the respondent sued the United States in the District Court to recover the capital stock taxes paid. (R. 2–7.) The respondent at no time has questioned the correctness of the amounts collected, if it was liable for this type of tax at all. The case was, of course, tried by the court, without a jury. The parties entered into a stipulation as to the facts, which the court accepted as its findings. (R. 12–22, 29.) It entered judgment for the United States, which the Circuit Court of Appeals reversed. (R. 59, 72.)

The facts as found may be epitomized as follows:

The respondent is a corporation organized in 1906 under Article V of the Insurance Law of New York relating to title and credit guaranty corporations (Laws 1892, c. 690, printed in petitioner's brief in No. 355, at pp. 51–53). As such it has been, and now is, subject to supervision by the State Superintendent of Insurance, to whom it makes annual reports. (R. 12, 14.)

The respondent's business consists of the insurance of titles to real estate and dealing in real estate mortgages, in the manner explained below. (R. 17.) It insures titles to many tracts of real estate as to which no application for a loan is made to it. Its mortgage business is carried on as follows: It receives applications for loans

secured by first mortgages on real estate. On receiving such an application the respondent makes an appraisal of the security and a search of the title. If these preliminary matters are satisfactory, the respondent prepares and the applicant executes a bond and mortgage. Thereupon the face amount of the loan is paid by the respondent to the applicant, less the charges for its services, and for recording, and less a fee for title insurance, which is always made a condition of the granting of the loan. (R. 17–18.) Thereafter the bond and mortgage, or certificates of participation therein, are sold or assigned to investors, for their face value. When a bond and mortgage are sold the respondent delivers to the investor a "Mortgage Guarantee," called a "policy." (Exhibit N, R. 51–53.) In the case of the sale of a participation certificate (Exhibit O, R. 53–54), there is incorporated in the certificate itself terms corresponding substantially with those in the "Mortgage Guarantee."

By the "guarantee" or participation certificate, the purchaser or investor appoints the respondent as his agent to collect the principal and interest on the bond and mortgage. The respondent guarantees payment of the principal as soon as collected, but in any event within twelve months after the same becomes due, and payment of interest at a specified rate, which is usually one-half of one per cent less than the rate specified in the bond. This difference, called a "premium," is retained by

respondent and constitutes the consideration for the sale of the mortgage and its accompanying guaranty, or of the certificate. The policies and certificates also guarantee that the mortgage is a valid first lien upon a good and marketable title in fee to the real estate.

The "guarantee" and participation certificate both cover the assigns of the purchaser. The certificate provides that it may be assigned by endorsement thereon "but only when such assignment is registered on the books of the company," and that the company may cancel the certificate at any time by giving thirty days' notice in writing to the purchaser and paying "the amount owing for principal and interest." (Exhibit O, R. 54.)

The respondent does not make loans for its own investment primarily, but for the purpose of selling the bonds and mortgages. (R. 19.) In making assignments of bonds and mortgages or of fractional certificates the respondent always enters into the guaranty described. The average length of time between the making of the loans and their subsequent transfer to investors is approximately two months. (R. 18.) The interest earned in the intervening period is part of respondent's gross income. It holds or sells no mortgages except those which it acquires and guarantees in the manner above described, and guarantees no mortgages except those over which it has complete control. (R. 17–19.)

In conducting its business respondent did not segregate its assets, but used them indiscriminately in all its activities. It made no segregation on its books of its expenses. It always kept on hand a sufficient quantity of its bonds and mortgages to maintain the guaranty fund supposedly required by Article V of the New York insurance law. (R. 21–22.)

By the law of New York corporations organized under its banking statutes and subject to supervision by the State Banking Department may be authorized to make mortgage loans and to sell them with guarantees. During 1921 to 1925, inclusive, at least two companies thus organized and supervised were so engaged. (R. 22.)

Other factual matters are discussed in the argument.

SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred in not holding that the respondent was taxable under Section 1000 of the Revenue Act of 1921 and Section 700 of the Revenue Act of 1924.

SUMMARY OF ARGUMENT

Sections 1000 of the Revenue Act of 1921 and 700 of the Revenue Act of 1924 imposed a special excise tax on every domestic corporation but also provided that the "taxes imposed by this section shall not apply * * * to any insurance company subject to the tax imposed by section * * *

246." The respondent contends, and the Circuit Court of Appeals held, that it was an "insurance company subject to the tax imposed by section 246," and consequently not liable to the capital stock tax. We contend that it was not such a company.

Our position here, as in *Bowers* v. *Lawyers Mortgage Company*, No. 355, October Term, 1931, is that a corporation is not such an insurance company if it derives a substantial portion of its income from a distinctive line of business other than insurance, as that term is commonly understood.

The respondent here, in addition to its business of selling guaranteed mortgages, did a title insurance business. The Bureau of Internal Revenue has ruled that a corporation which derives practically all of its income from premiums on title insurance policies and fees for searches and the like, which are necessarily preliminary to the issuance of such policies, is an insurance company. But a substantial portion of the income of the respondent here came from activities which were not connected with its title insurance business. A considerable percentage arose out of the making of loans on mortgages and sales of bonds and mortgages, with the company's "guarantee," which was the "primary purpose" (R. 19) in the making of loans by respondent. These activities, characteristically those of an investment company, can not be regarded as incidental to the title insurance business.

The judgment of the District Court should be affirmed and the judgment of the Circuit Court of Appeals should be reversed.

ARGUMENT

Section 1000 of the Revenue Act of 1921 and Section 700 of the Revenue Act of 1924 imposed a special excise (capital stock) tax on every domestic corporation but they also provided that the "taxes imposed by this section shall not apply to any insurance company subject to the tax imposed by section * * * 246." Section 246 was substantially the same in each of the Acts. The respondent contends, and the Circuit Court of Appeals held, that it was an "insurance company subject to the tax imposed by section 246," and consequently not liable to the capital stock tax. We contend that it was not such a company.

Our position here, as in *Bowers* v. *Lawyers Mortgage Co.*, No. 355, October Term 1931, is that a corporation is not such an insurance company if it derives a substantial portion of its income from a distinctive line of business other than insurance, as that term is commonly used. (For the argument on this point, see pp. 11–22, in brief of the petitioner in that case.)

The respondent here did a considerable title insurance business. It issued to persons with whom it had no other transactions policies of title insurance, for which it received fixed charges. And

solely as preliminary steps thereto, it examined and prepared abstracts of title and made searches and procured information in relation to the real estate involved. If the title was found to be uninsurable the respondent was reimbursed for its time and expenses in investigating the title, and if the policy was issued the respondent charged not only a premium for the policy based on a scale dependent upon the amount of the policy, but also fees for the preliminary work.

If the respondent had done no other business, it would have been entitled to classification as an insurance company taxable under Section 246. In several cases presenting such a situation the Bureau of Internal Revenue has so ruled. S. M. 5501, C. B. V–1, p. 102; G. C. M. 5355, C. B. VII–2, p. 160. We do not question the correctness of these rulings. See *Trenton Potteries Co.* v. *Title Guaranty & Trust Co.*, 50 App. Div. 490, and authorities there cited.

But the aggregate of all of the premiums and charges mentioned above constituted only about one-half of the gross income of the respondent in any of the years here involved exclusive of interest received.[1] The other one-half arose from the making and selling of mortgage loans.

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[1] See our tabulation made from an examination of the statements in the reports made by the respondent to the New York Superintendent of Insurance (R. 15–16) and the reallocation of the items made by the respondent itself (R. 19), evidently for the purpose of this case, Appendix, p. 15, *infra*.

The respondent made loans on mortgages and charged the mortgagors fees for its service. It sold substantially all of the mortgages soon after it acquired them, the average period during which it held mortgages before selling them not exceeding two months. When it sold all of a mortgage to a single investor, it issued a so-called "policy of mortgage guarantee," and when it sold the investor only a part interest in a mortgage it issued a document entitled "guaranteed first mortgage certificate." (R. 17–18, Exhibits N and O, R. 51–54.) These documents are very similar to those involved in the case of the *Lawyers Mortgage Co.*

It is true that in the instant case the respondent in its policies and certificates, in addition to its other undertakings, guaranteed "that the said mortgage is a valid first lien upon a good and marketable title in fee to the property." And it is a fact that the respondent in the instant case, before making the loan, examined the title to the property, and, unlike the Lawyers Mortgage Company, it did not take out title insurance in another company. Because of these facts, the respondent has argued that most of the fees which it received from the mortgagors should be considered as compensation for services which are akin to those performed where the company insured the title for one to whom it made no loan. And in the table (R. 19) (evidently prepared for this case) it has artificially allocated to its guaranty as to the mortgage lien about sixty per centum of the fees received from

the mortgagors. The District Court did not consider the propriety of such allocation, and we submit that there is nothing in the findings which requires this Court to accept that allocation or to attribute any significance to it. The guaranty as to the lien added nothing either to the respondent's obligations nor to the investor's protection, because the respondent made the broad promise to make payment both of the principal and interest in any event, and at the same time it sold the mortgage or a share in the mortgage to the purchaser. Moreover, we submit that no fees paid by the borrower can be considered as compensation for a guaranty made to the assignee of the mortgage.

The outstanding significant fact is that the respondent here, like the Lawyers Mortgage Company, was engaged in the business of selling guaranteed mortgages and derived a large part of its income from this business. Its undertakings in the contracts under discussion, whatever their nature, were incidental to the sales of the mortgages. The business of the respondent in respect of guaranteed mortgages was exactly the same kind of a business as that of the Lawyers Mortgage Company, and it can not be that Congress intended to make a distinction between two such companies for purposes of taxation merely because of minor differences in their forms of contract.

If, however, the Court should deem it necessary to examine the items of the respondent's income in

detail, it may be assisted by the following analysis.

The sum total of the fees paid to the respondent by the mortgagors represent in the aggregate a very substantial portion of the respondent's income, ranging from about thirty per centum to forty per centum of the total gross income of the respondent, exclusive of its investment income, etc.[2]

We submit that none of these fees can be attributed to the insurance business. In each year there was a substantial amount of income,[3] consisting of fees and charges paid by the mortgagors, which the respondent has not attempted to allocate to the guaranty as to the mortgage lien. In none of the five years in question did these items aggregate less than one-eighth of the total gross income of the respondent, exclusive of interest, etc. This by itself, we submit, is a sufficient proportion of the gross income to remove the respondent from the class of corporations deriving substantially all of their income from insurance business, even if guaranteeing mortgages be considered insurance. See G. C. M. 6988, C. B. VIII–2, p. 213.

And if, as we contend, the guaranteeing of mortgages is not insurance, about thirty per centum[4] of the income of the respondent in each year was attributable to activities other than insurance, even if we should concede that the respondent's alloca-

[2] See Appendix, p. 15, *infra*.

[3] Items (2) and (5) in respondent's table set forth in the findings. See R. 19–20.

[4] The sum of items (1), (2), and (5) in the table prepared by respondent (R. 19).

tion of income to guaranty of the lien of mortgages sold by it is tenable.

So, even upon the assumptions of the respondent as to the proper allocation of its figures, we contend that it was not an insurance company subject to the tax imposed in Section 246. And *a fortiori*, if any of our contentions as to allocation of its income are correct, it can not be so classified.

CONCLUSION

We respectfully submit that the judgment of the Circuit Court of Appeals should be reversed, and the judgment of the District Court should be affirmed.

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JANUARY, 1932.

APPENDIX

Table showing proportion of respondent's income received from various sources

	Total gross income, exclusive of interest received and some small miscellaneous items	Income from all fees and charges applicable to title insurance (apart from transactions in which the respondent made mortgage loans)	Income from fees paid by mortgagors[1]	Interest retained as "premiums" on mortgage guaranties[2]
1921	$630, 291. 01	$270, 030. 79	$248, 864. 33	$90, 449, 14
1922	925. 596. 83	406, 019. 93	376, 899. 25	105, 750. 08
1923	1, 059, 912. 07	565, 155. 86	317, 388. 75	134, 349. 66
1924	1, 160, 895, 92	576, 771. 36	355, 943. 68	175, 641. 39
1925	1, 420, 509. 85	714, 949. 06	416, 355. 15	227, 869. 98

[1] This item represents the sum of items 2, 4, and 5, appearing in the allocation table prepared by the respondent, appearing at R. 19.

[2] This is item 1 shown in this table, there designated as "Income consisting of the difference between the interest received and guaranteed by plaintiff in connection with its mortgage guarantees." (R. 19.)

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